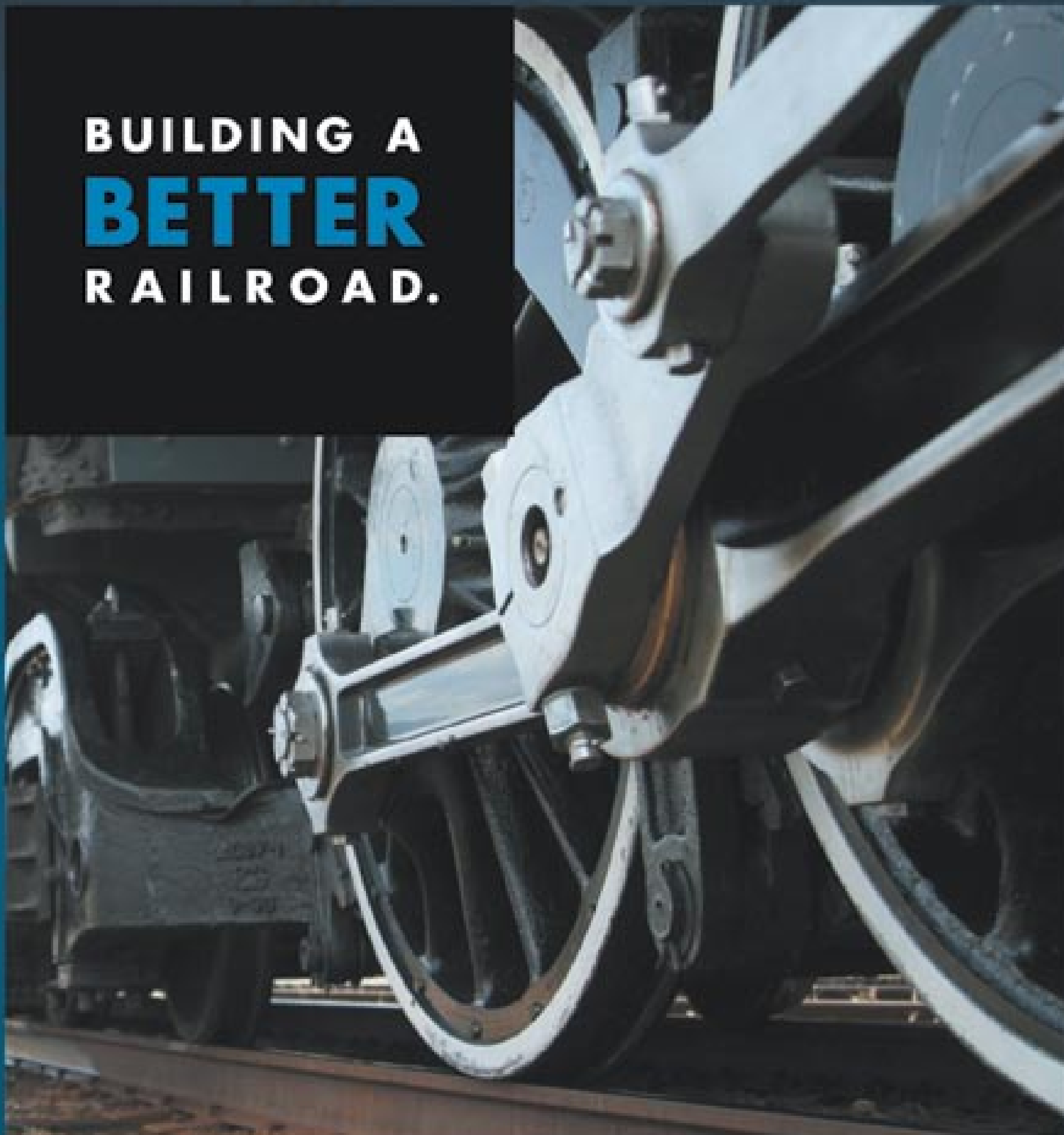
# BUILDING A BETTER RAILROAD.



NORTH CAROLINA RAILROAD COMPANY

## 2009 Annual Report

# BUILDING A BETTER RAILROAD

*Work goes on into the night as crews work to finish the Elon University pedestrian underpass by mid-May, 2010.*

*Photo: Neil Bromilow*

# The Mission of the North Carolina Railroad

*To maximize the value of the North Carolina Railroad Company's properties for the people of North Carolina through partnerships that drive economic growth, enhance freight and passenger service, improve safety and respect the natural environment.*


*An Amtrak passenger train pulls into the Burlington station, home of Whistlestop, an exhibit about the North Carolina Railroad and its role in the state's development.*

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## FRIENDS OF THE NORTH CAROLINA RAILROAD COMPANY,

*Today, we're shifting our focus to projects that will help us maximize the way the railroad is used for both passenger and freight service.*

Now as never before, rail matters to North Carolina. As a passenger transportation system, an effective method of transporting freight, an engine for economic development, a dependable source for job creation and as a way to lighten the carbon footprint on our state's fragile ecosystem, rail is undergoing a renaissance. It is our mission here at the North Carolina Railroad to make sure that we leverage the use of this 317-mile, 200-foot-wide railroad in ways that increase its value for the people of the state.

To do that requires a vision generated by strategic thinking that will guide us as we shift from a decade-long tradition of choosing capital improvement projects to repair the railroad. Today, we're shifting our focus to projects that will help us maximize the way the railroad is used for both passenger and freight service. As we move to address the demands of the new economy, these projects will allow more trains to operate on the railroad at higher speeds and with a greater degree of safety. For example, in a nation of aging infrastructure, NCRR has replaced, renovated or refurbished 17 bridges in the last five years, mostly in the eastern part of the state. By looking ahead and fixing these bridges, North Carolina was able to attract businesses to the eastern part of the state that will use the railroad to haul large freight cars to the port at Morehead City. Rail was a factor in siting eleven new businesses in North Carolina in 2009, creating thousands of jobs.

Because the railroad has the potential for so many uses, we must work closely with our public and private sector partners. North Carolina was awarded $545 million in American Recovery and Reinvestment Act funds (ARRA), about $315 million of which will be spent by the North Carolina Department of Transportation's (NCDOT) Rail Division on NCRR projects. These include projects such as double tracking the railroad in places where it's a single track so more trains can use it, and to straighten curves so trains can go faster.

Norfolk Southern is our freight operating partner; the operating agreement with them is the source of our capital improvement funding. This allows us to improve the railroad at no cost to the state. Norfolk Southern, while operating in these challenging economic times, sees its future in efficiently designed, strategically placed corridors such as the Crescent corridor, of which NCRR is a part.

Another important opportunity for partnership involves safety. We will continue to work closely with Operation Lifesaver—a rail-sponsored safety organization—as well as with Norfolk Southern, NCDOT's Rail Division and communities statewide to educate people about using caution at all crossings, and to always expect a train.

NCRR looks forward to building a better railroad to help our state attract new businesses and rail-served industries, and to improve transportation as we move ahead into 2010. We will be readying the railroad for even more uses in today's high speed world.

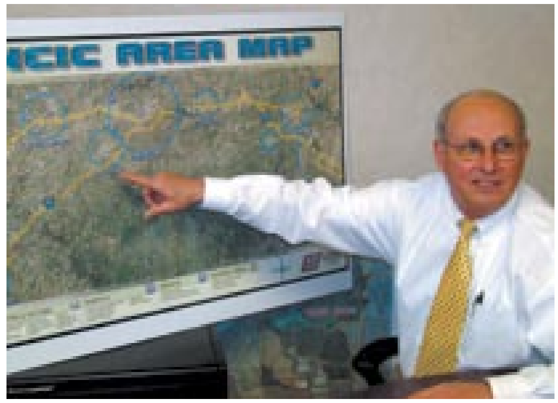
**JOHN ATKINS**
Chairman of the NCRR
Board of Directors

# ECONOMIC DEVELOPMENT AND PROPERTIES

**Economic Development**
NCRR took a proactive approach to economic development this year, fueled by its role in the state's successful attraction of Spirit AeroSystems, Sanderson Farms and Golden State Foods, and the substantial number of jobs they are bringing to North Carolina. NCRR works closely with the Department of Commerce to locate, preserve and promote railroad industrial sites which are rapidly disappearing due to the state's steady growth.

The company is an active participant in the North Carolina Economic Developers Association, and maintains contact with economic developers statewide. At its forum on rail-related issues this year, NCRR is sponsoring an event to highlight the state's best industrial rail-served sites and to focus economic developers' attention on these sites.

Working closely with Norfolk Southern, NCRR is encouraging the military bases in eastern North Carolina to increase their use of rail services. This year, Camp Lejeune is transporting additional military equipment by rail. For example, one train transporting primarily jeeps, tanks and other vehicles had 80 rail cars carrying over 275 military vehicles. Had this move traveled via highway, it would have used 250 trucks.



*Richard Wiley, Senior Consultant for Economic Development, stresses the importance of preserving the state's rapidly disappearing industrial rail sites.*

**Properties**
A parcel of land was purchased near Pine Level to allow for the construction of a roadway to provide alternative access to a small church and several houses as part of a project to remove a private roadway that crosses NCRR tracks.

*NCRR is encouraging military bases in eastern North Carolina to increase their use of rail services.*

*One train transporting primarily jeeps, tanks and other vehicles had 80 rail cars carrying over 275 military vehicles. Had this move traveled via highway, it would have used 250 trucks.*

# MAJOR CAPITAL IMPROVEMENTS

## Committed Projects

### Charlotte

**Grade Separation, Sugar Creek Rd.**
Grade separation of main freight/pass. line at Sugar Creek Rd. under study. Joint safety project with NCDOT.
**Benefit:** Improve safety-freight/pass
**Total cost:** $34,000,000 **NCRR cost/share:** $10,000,000

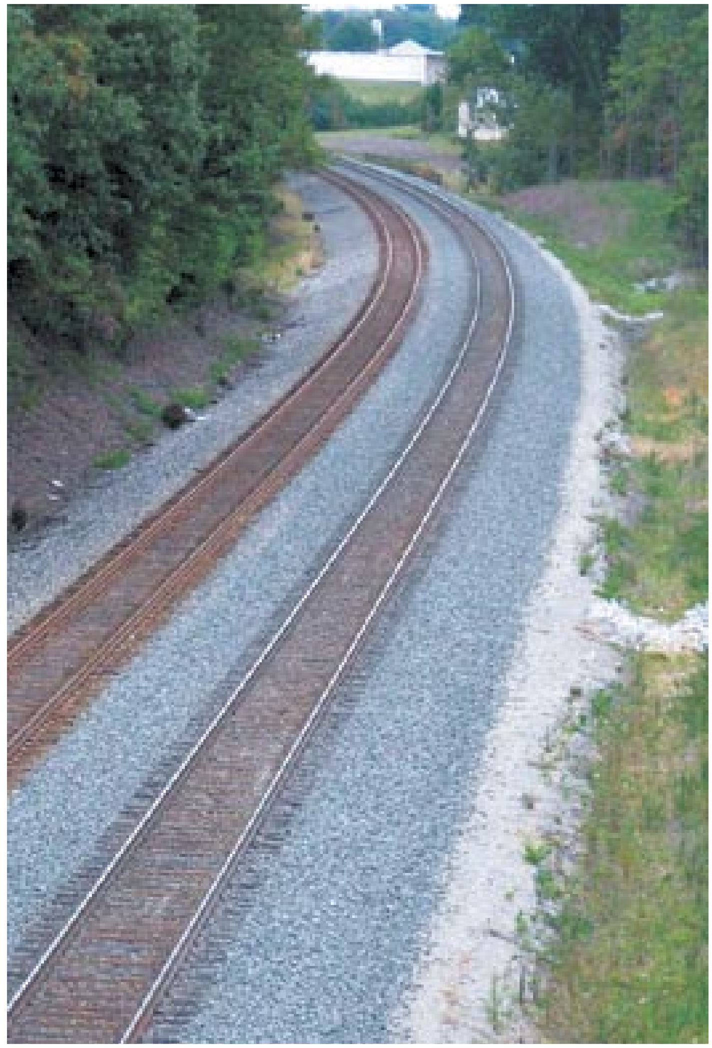
### NCRR Corridor

**Commuter Rail Shared Corridor Track Expansion Study**
Determine the infrastructure requirements and costs for potential future commuter rail within the NCRR corridor (Goldsboro to Burlington; Burlignton to Greensboro). Conduct market/ridership analysis.
**Benefit:** Study
**Total cost:** $1,450,000

### NCRR Corridor

**Survey/Monumentation Project**
Establish permanent rail corridor monumentation for corridor management and engineering/planning purposes. Incorporate geodetic monuments in statewide survey grid.
**Benefit:** Corridor management
**Total cost:** $2,000,000

*NCRR and Elon University partnered to construct a pedestrian underpass to improve safety.*



*NCRR, NCDOT and Norfolk Southern constructed nine miles of double track between Greensboro and High Point.*

### Davidson and Rowan Counties

**Rail work at the I-85 Bridge – Yadkin River**
This project will widen portions of I-85 to eight lanes, replace six existing bridges, and replace two existing railroad grade separations near the Yadkin River in Rowan and Davidson Counties.
**Benefit:** Improve safety and speed (rail work only)
**Total cost:** $4,500,000** **NCRR cost/share:** $3,000,000
***Received $1.5 million in ARRA funding*

### Raleigh–Charlotte

**Construct Three Pedestrian Underpasses**
Construct pedestrian underpasses in 3 selected pilot locations in connection with grade crossing closures or high volume pedestrian locations. One joint project with Elon University will be completed in 2010.
**Benefit:** Improve safety
**Total cost:** $6,000,000 **NCRR cost/share:** $3,000,000

### Kinston

**Rail/Truck Loading & Spur Track**
Rail/truck loading ramp and spur track, Kinston to serve Global Transpark and other users. Project includes site work, road access, and staging area for transfer point.
**Benefit:** Economic development
**Total cost:** $900,000

## Kinston

**Curve Realignment**
Straighten curve in downtown Kinston to increase speed to 25 mph.
**Benefit:** Improve safety and speed
**Total cost:** $3,300,000

**Bridges EC-27.8 and EC-27.9**
Rebuild wooden trestle bridges over the Neuse River.
**Benefit:** Improve safety and speed
**Total cost:** $8,000,000 **NCRR cost/share:** $4,000,000

## Craven and Lenoir Counties

**EC Line Bridge Replacements**
Replace single track trestle over creeks in Lenoir and Craven Counties to address settling piers and weight requirements. Joint project with Norfolk Southern.
**Benefit:** Improve safety and speed
**Total cost:** $3,000,000 **NCRR cost/share:** $1,500,000

## Selma – Morehead City

**Grade Crossing Improvements**
Improve grade crossing protection on unsignalized or partially signalized grade crossings between CSX Junction at Selma and Morehead City (115 miles). Joint project with NCDOT and Norfolk Southern.
**Benefit:** Improve safety and speed
**Total cost:** $7,641,750 **NCRR cost/share:** $2,227,200

# Funded by American Recovery and Reinvestment Act grant

## Thomasville – Lexington

**Double Track, 4.2 Miles**
This work is to improve capacity by extending second track and signals to reduce delays associated with meeting and passing trains (Bowers-Lake).
**Benefit:** Improve capacity (Main Line)
**Total cost:** $47,545,437 (NCDOT high speed rail)
**NCRR cost/share:** $4,000,000

## N. Charlotte – Concord

**Double Track, 12.1 Miles**
This work is to improve capacity by adding a second track and signals to reduce delays associated with meeting and passing trains between Concord and Charlotte (Haydock-Junker).
**Benefit:** Improve capacity (Main Line)
**Total cost:** $95,116,212 (NCDOT high speed rail)
**NCRR cost/share:** $13,000,000

## Kannapolis – Salisbury

**Double Track, 10 Miles**
This work is to improve capacity by extending second track and signals to reduce delays associated with meeting and passing trains (N. Kannapolis-Reid).
**Benefit:** Improve capacity (Main Line)
**Total cost:** $92,593,479 (NCDOT high speed rail)
**NCRR cost/share:** $10,000,000

*Continuous welded rail being laid in New Bern.*

# MAJOR CAPITAL IMPROVEMENTS

## Completed Projects

### High Point – Greensboro

**Double Track, 9 Miles**
Improve capacity by adding a 2nd track (Cox-Hoskins) to reduce delays associated with meeting and passing trains. DOT studies have identified this portion of railroad as one of the most congested.
**Benefit:** Improve capacity and efficiency
**Total cost:** $21,000,000 **NCRR cost/share:** $4,000,000
**Completed 2009**

### Durham County, Research Triangle Park

**Acquire Property to Straighten Curve at Hopson Road****
Acquire acreage for future straightening of curve in Durham Co. in RTP for adding passing siding and improving curvature to allow higher speeds for freight and passenger trains
**Benefit:** Improve capacity and speed.
**NCRR cost/share:** $2,000,000
**Completed 2006**
***Bridge, curve straightening and 2-mile siding will be completed as part of NCDOT's ARRA High Speed Rail grant*

*NCRR added a team track in Kinston to serve Global Trans Park.*

*Super gangs work to install welded rail in New Bern.*

### Durham, Research Triangle Park

**Replace NC 54 Railroad Bridge-RTP**
Replace existing single track RR bridge in RTP with double track bridge and accommodate regional transit operations; improve traffic flow and eliminate substandard clearance.
**Benefit:** Improve rail capacity and ease vehicle congestion
**Total cost:** $5,500,000
**Completed 2006**

### Durham (Funston)

**Extend Siding 1+ Mile**
This work is to extend passing siding and straighten curve west of Durham for approximately 1-mile segment.
**Benefit:** 35 minutes passenger trains
**Total cost:** $3,558,000 **NCRR cost/share:** $75,000
**Completed 2003**

### Raleigh – Goldsboro

**Construct Three Segments of Passing Tracks and CTC & Communications**
Improve capacity by adding 3 passing tracks totalling approx. 8 miles between Raleigh and Goldsboro to improve passenger and freight train performance and service. Add centralized traffic control 31 miles; raise to same standard as Raleigh–Charlotte to improve speed performance and reliability, and accommodate growth of freight and passenger service. Install Cabarrus Street Interlocking and revise track layout to increase speed to and from yard. Improve Boylan Storage Track.
**Benefit:** Capacity improvement, Electronic traffic control
**Total cost:** $22,600,000
**Completed 2008** (Boylan Storage Track in 2009)

### Raleigh – Selma

**Upgrade track condition between Raleigh and Selma**
Increase passenger speed to 59 mph for approx. 30 miles; upgrade crossing circuits
**Benefit:** 35 minute passenger trains
**Total cost:** $2,400,000 **NCRR cost/share:** $1,750,000
**Completed 2002**

### Clayton

**Replace Restricted Bridge: MP H-95.2**
Replace bridge structure on main line to eliminate speed restriction and improve clearance on Hwy. 70 Bus.
**Benefit:** Improve safety and speed
**Total cost:** $1,000,000
**Completed 2008**

### Johnston and Alamance Counties

**Repair/Renovate Neuse R. Bridge (Johnston County), Hwy 87 Bridge (Alamance County)**
Bridges have clearance and track restrictions.
**Benefit:** Improve clearance/loading
**Total cost:** $500,000
**Completed 2009**

### Kinston

**Repair/Replace Neuse River Bridge; Improve Rail**
Increase load of bridge to permit 286,000 lb standard railcars as other segments of NCRR and allow port traffic; replace jointed rail with continuous welded rail (remaining 14 mile segment).
**Benefit:** Improve reliability
**Total cost:** $7,100,000
**Completed 2004**

### Kinston

**Replace Jointed Rail**
Replace jointed rail with continuous welded rail (17-mile segment) same as Project I-(B)1.
**Benefit:** Increase load rating; Replace rail
**Total cost:** $4,950,000
**Completed 2005**

### Craven County

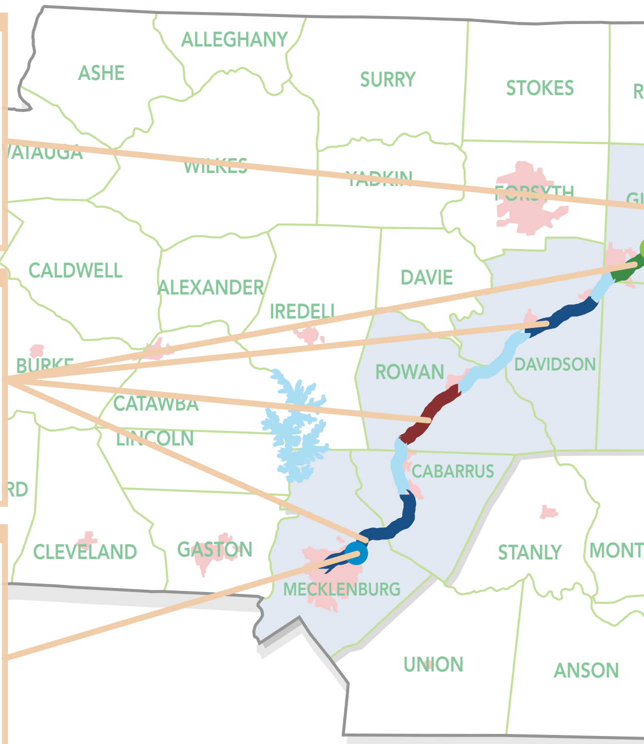
**Replace Bridge Trestle at Batchelder Creek**
Replace single track wooden trestle over Batchelder Creek in Craven County.
**Benefit:** Improve capacity and safety
**Total cost:** $450,000
**Completed 2006**

### Havelock/Morehead City

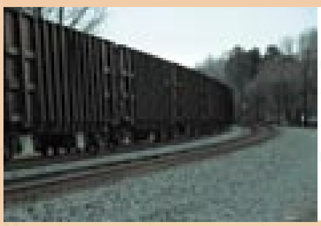
**Feasibility Study: Main Line Relocation**
Evaluate feasibility of relocating the main line off of Hwy. 70 in Carteret Co. between Cherry Point MCAS and the Morehead City State Port Terminal to improve service and safety to/from the Morehead City Port; elim. traffic crossings and hazards, and promote industrial development. Feasibility recommendations to include participants, finance sources and alternatives.
**Benefit:** Main line
**Total cost:** $500,000
**Completed 2007**

*Double track adds capacity to the railroad, improving efficiency for freight and passenger trains.*

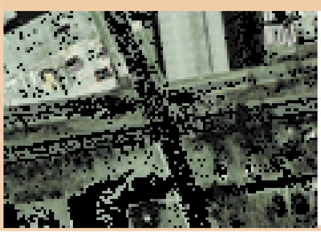
# CAPITAL IMPROVEMENT PROJECTS




**Elon University Pedestrian Overpass:** Provide safe means for pedestrians to cross track on college campus with heavy foot traffic.
**Funding Partner:** Elon University



**Four Double Track Projects**
Double track over 35 miles in four different segments on high volume main line
**Funding Partners:** NCDOT and Norfolk Southern



**Sugar Creek Road Bridge**
Preliminary design to discern cost of separating road from rail on the corridor's busiest crossing
**Funding Partners:** To be determined

### Bridge and Crossing Improvements

Improvement Name and Status

- Batchelor Creek Bridge Trestle
- Bridge Replacement at e-019.5
- Bridge Replacement at e-020.7
- Clayton Restricted Bridge
- Grade Crossing Improvement Program
- Hopson Road Alignment Bridge and Curve (Future)
- NC Hwy 54 Bridge
- NC Hwy 87 Bridge
- Neuse River Bridge - Kinston
- Neuse River Bridge - Wilson's Mills
- Pedestrian Underpass - Elon University
- Sugar Creek Rd. Bridge / Grade Separation (Future)

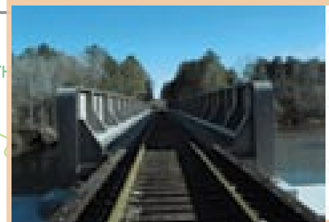
### Track Improvements

Improvements Name and Status

- Charlotte to Concord (Future)
- Cox to Hoskins Double Track
- East Durham New Main Track
- Goldsboro to Morehead City Replace Rail (Future)
- Kannapolis to Salisbury (Future)
- Kinston to New Bern Replace Rail
- Lexington to Thomasville (Future)
- Raleigh to Goldsboro Siding and Signals

**Highway 54 Bridge**
New railroad bridge has double track capacity and opens up a vehicular bottleneck in Research Triangle Park

**Clayton Bridge**
Replaced oldest bridge on the railroad with a new span allowing freight and passenger trains to increase speeds.



**Neuse River Bridge**
A new bridge in Kinston that can handle today's bigger, heavier trains replaces a 100-year old hurricane damaged structure.


**Siding and Signals**
Increases track capacity and allows trains to increase speed and pass between Raleigh and Selms, improving on time performance.

**Welded Rail**
Outdated, lightweight 90-lb. rail is replaced by seamless, heavier gauge welded rail to improve speed and safety between Goldsboro and Morehead City.

# COMMUTER RAIL RIDERSHIP STUDY


The Shared Corridor Capacity Study, completed in 2009, considered 4 different routes over 140 miles between Greensboro and Goldsboro.

NCRR retained Steer Davies Gleave of Boston to study what the potential ridership and revenue market for would be for commuter rail service within its 140-mile rail corridor between Greensboro and Goldsboro.

The eight-month study is expected to be complete in early May, 2010. It is a follow-up to a 2008 NCRR engineering study that concluded with significant improvements commuter trains and freight trains could co-exist in the Goldsboro-Greensboro corridor. Commuter trains would run primarily in the morning and late afternoon, which is in contrast to light rail that operates throughout the day.

*Steer Davies Gleave will prepare ridership models and revenues forecasts for four potential commuter train routes in the seven-county area for 2012, 2017 and 2022.*

Steer Davies Gleave will prepare ridership models and revenues forecasts for four potential commuter train routes in the seven-county area for 2012, 2017 and 2022. Those routes could be:

- Goldsboro to Raleigh through Selma, Clayton and Garner
- Raleigh to Burlington through Cary, Research Triangle Park, Durham, and Hillsborough
- Greensboro to Raleigh through Gibsonville, Elon and Burlington
- Chapel Hill/Carrboro connections to Raleigh and Greensboro

The study area also includes 18 state and private universities within two-mile access to the rail line, including NC State, Shaw, UNC-Chapel Hill, Duke, NC Central, UNC-Greensboro, Elon and NC A&T.

The studies are part of NCRR's capital investment planning for 2030.

"From its early beginning our company has looked over the horizon to determine how this important asset can be used to benefit economic development and transportation in North Carolina," said Scott Saylor, NCRR president. "We look forward to working with communities to explore the potential use of the rail line for the public and business over the next couple of decades."

The study will include:

- A travel survey of citizens and major businesses in the market areas.
- Development of a travel forecasting model (modified Triangle Regional Model and Piedmont Triad Regional Model) and use of other forecasting tools.
- Estimate of ranges of projected fares to provide a basis for fare box revenue.
- Evaluation of land use patterns and their effects upon ridership demand.
- Examination of bus routes for feeder and distributor services.

The study costs approximately $300,000 and NCRR is funding it from its own revenues, derived from its operating agreement with Norfolk Southern. Study results will be shared with the public and local and regional planning officials. Results and a summary of the study will be available at www.ncrr.com.

# NCRR BUILDING TIES

*The NCRR hy-rail vehicle affords an engineer's view of the railroad. Left to right: John Brantley, RDU, Jeff Merritt, Triangle Transit, Joe Milazzo, Regional Transportation Alliance, Scott Saylor, NCRR, Rick Weddle, Research Triangle Foundation, David King, Triangle Transit.*

In 2009, NCRR launched an effort to better get to know the communities, municipalities and people along the corridor. Because the railroad passes through the middle of the state and touches many lives and businesses, the company wants to know its neighbors. By getting involved, working with communities and keeping them informed, NCRR wants to build not only a better railroad, but also better partnerships throughout the state. Here are some of the year's efforts.

**Open House: Kinston Track Improvements**
Improvements to enhance safety, speed and economic development on the North Carolina Railroad were discussed at an Open House in September 2009, in Kinston. The event was jointly hosted by Pride of Kinston and NCRR. Norfolk Southern Railway, freight operator on NCRR, also participated.

The event kicked off a nine-month project to realign the tracks between Mitchell and North Independence Streets in downtown Kinston, which began in mid-September. The realignment will permit increased train speed from the current 10-mph to 25-mph, enabling trains to clear in-town crossings more quickly. Faster trains reduce traffic delays at crossings.

Further, the recent removal of the old freight depot plus the downtown track realignment will allow today's larger rail cars, such as those used by Spirit AeroSystems and Camp Lejeune, to pass through, further opening up eastern North Carolina for rail-served industries and the military.

Also underway was construction of a transload track to serve the Global TransPark, creating a siding and truck/rail loading ramp for Spirit and other future users. The cost to NCRR for both projects, funded out of NCRR freight revenues, is approximately $3.5 million. Under a separate project, the North Carolina Department of Transportation is constructing a six-mile rail line to directly connect the Global TransPark to NCRR.

The open house event began with brief comments from Kinston Mayor O.A. (Buddy) Ritch and several business and civic leaders. During the Open House representatives from NCRR, Pride of Kinston and Norfolk Southern were available to answer questions.

NCRR has invested more than $60 million east of Raleigh since the start of its capital improvement program in 2001, including about $17.6 million in Lenoir County.

*Because the railroad passes through the middle of the state and touches many lives and businesses, the company wants to know its neighbors.*

Catherine Campbell, NCRR, and Kristen Nunnally, Norfolk Southern, at a military vehicle load out with soldiers from Camp Lejeune.

*The goal of the forum is to foster discussion, ideas and information among those with an interest in rail in order to enhance the state's rail assets.*

Projects Include:

- Neuse River bridge
- Welded rail
- Transload track in GTP
- Replace bridge trestle in Craven County (Batchelder Creek)
- Eastern grade crossing project
- Curve straightening in Kinston

In attendance were Mayor O.A."Buddy" Ritch, Scott Stevens, Kinston City Manager, members of the Kinston City Council, Adrian King, Executive Director, Pride of Kinston, Mark Pope, Executive Director, Lenoir County Economic Development, Rick Davis, Spirit AeroSystems, Dominik Browne, General Manager for Norfolk Southern's Business Units and NCRR Board members Bob Griffin, Dave Woodard and Fred Ruffin, and former members P.C. Barwick and Pou Rochelle.

**Forums: Progress In Motion: 2030 and 2010: Rail and the New Economy**

The role that North Carolina's freight and passenger train service could play in the state's transportation future was the focus of *Progress in Motion: 2030*, a March 19 forum in Raleigh, held at the McKimmon Center and hosted by NCRR. Experts from the freight, passenger and transit sectors shared their insights and answered questions about costs, benefits, environmental challenges and potential partnerships. The morning session dealt with freight rail service and the rail industry as an economic engine. The afternoon session focused on passenger service and transit driven investment.

*"Progress in Motion: 2030"* speakers included North Carolina Secretary of Transportation Eugene A. Conti, Jr., former Governor James B. Hunt, former Norfolk Southern Senior Vice President for Strategic Planning James McClellan, and officials with mass transit organizations in Charlotte, the Triad and Triangle, and Norfolk Southern, CSX and Amtrak. Also participating were business leaders, economic developers and local government representatives. NCRR hosted the forum as part of its 2030 long range planning effort.

*2010: Rail and the New Economy* is a forum for those interested in how railroads contribute to North Carolina's transportation system and enhance its economic and environmental efforts.

The goal of the forum is to foster discussion, ideas and information among those with an interest in rail in order to enhance the state's rail assets.

This year, the forum will be preceded by special events, networking, discussions and presentations at the Depot, a restored former NCRR freight rail warehouse in downtown Raleigh. Experts representing some of the industry's best thinking from our state and beyond have been invited to present their thoughts on passenger, freight, transit and rail-related economic development.

The forum was held May 10th and 11th, 2010. More information can be found at www.ncrr.com.

**Special Events**

By attending a variety of trade shows, conventions and public information meetings the company hopes to keep its fingers on the pulse of issues that are important to today's business and government communities. These events are important to the telling of the NCRR story, and for listening to the stories of the communities through which the railroad passes. Outreach at events and to organizations in 2009 include:

*A Norfolk Southern Operation Lifesaver locomotive pulls cargo though the countryside.*

- NC Chapter of American Planning Association
- NC League of Municipalities
- Selma Railroad Days
- NC Main Street
- NC Society of Surveyors
- NCDOT Rail Division public meetings
- NCRR Corridor Management Information public meetings
- NC Economic Developers Association
- Regional Transportation Alliance

**Safety**

NCRR continues to raise awareness of safety issues by participating in Operation Lifesaver's safety train program. We invite public officials, surveyors, planners, law enforcement personnel and others to ride a special train outfitted with video cameras so passengers can see exactly what the engineer sees. Riders see trespassers and people trying to beat the train at crossings. They can see how some encroachments can be dangerous in the corridor as well.

We also work with Operation Lifesaver on crossing blitzes. These are held at rail crossings that have recently been modified in some way, or where there has been a train-vehicle collision. Supervised by local law enforcement officers, volunteers approach drivers at designated crossings and distribute safety information and answer any questions that the drivers might have about reworked crossings. The goal is to heighten awareness of the dangers near or on the tracks, and to remind people to always expect a train or trains.

**NC One Call**

NCRR participates in the "Call Before You Dig" program as a way to learn of activity on the corridor. Currently, NCRR participates in the Wake County program and recently added the Johnston County program. The program is beneficial because it alerts NCRR to imminent activity that may require an agreement or corridor safety plan.

Since the program began on July 1, 2009:

- 608 requests handled
- 94 contacts made
- 4 requests resulting in new agreements, agreement modification, or encroachment removal

**Geographic Information Systems (GIS) Data Sharing**

NCRR enters into data sharing agreements with local governments to ensure their data accurately reflects the NCRR corridor enabling better decisions regarding planning, zoning and inspections.

*These events are important to the telling of the NCRR story, and for listening to the stories of the communities through which the railroad passes.*

# NORTH CAROLINA RAILROAD COMPANY OFFICERS AND DIRECTORS

### CHAIRMAN

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Research Triangle Park
President and Chairman and Chief Executive Officer, O'Brien/Atkins Associates

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US Air Force (retired)

**P. Eugene Upchurch III**
Raleigh
Vice President-External Relations, Progress Energy

This year, NCRR has shifted focus from primarily preserving and protecting the corridor for future use to engaging key partners to utilize the corridor more actively to benefit the economy, create jobs and improve transportation in the state. To achieve this goal, the Board committee structure was reorganized into the following four groups:

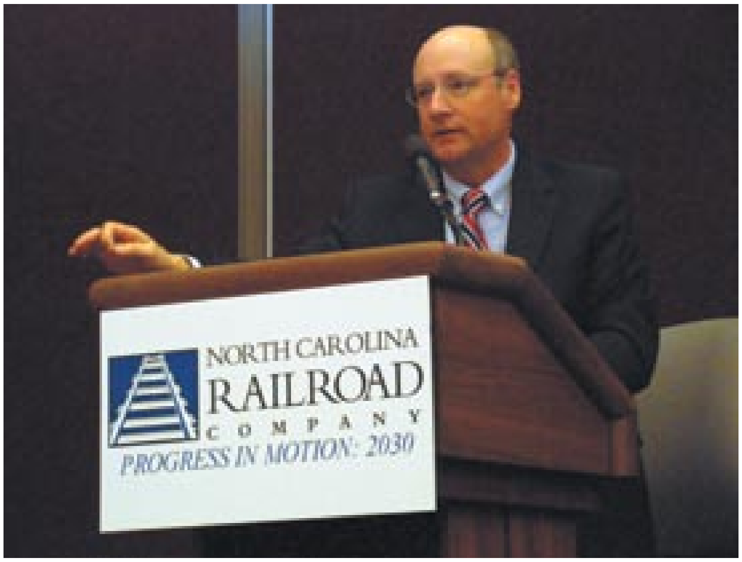
**Audit, Budget and Personnel**
This committee is responsible for oversight of the annual audit, including financial reporting and tax planning, and recommending cash management policies, personnel policies and budget matters. It also recommends ethics policies for directors and management. It is chaired by Murray Greason, with Marion Cowell, Sam Hunt, and Gene Upchurch serving as members and Dave Woodard, John Atkins and Scott Saylor as Ex officio.

**Corridor Management Policy**
This committee is responsible for developing corridor management policy and directives regarding right of way management. Planning falls under the purview of this committee, chaired by Dennis Rash, with members Bob Bleecker, Bob Griffin, John Pike and Fred Ruffin, and John Atkins and Scott Saylor as Ex officio.

**Economic Development**
This committee looks for ways to help bring rail-served industries to North Carolina, thereby helping to create jobs and promote economic growth. It develops project planning and focus, including policy recommendations for new partnerships, and recommend guidelines for new industry site direction and development. It also oversees Public Affairs policy and direction. It is chaired by Gene Upchurch, with members Bob Bleecker, Christie Cameron, Bill Kincheloe, John Pike, Fred Ruffin and John Atkins and Scott Saylor as Ex officio.

**Strategic Planning and Policy**
Taking the long view, this committee is responsible for future planning and use of the corridor, long range strategic planning and capital budgeting, and serves as the Norfolk Southern Policy and Planning committee liaison. It is also responsible for the development of the Capital Program and capital investments, including track, bridge and other improvements, based upon the Board's strategic objectives. This committee is chaired by Christie Cameron, with Marion Cowell, Murray Greason. Bob Griffin, Sam Hunt, Bill Kincheloe, Dennis Rash and Dave Woodard serving and John Atkins and Scott Saylor serving as Ex officio.

# NORTH CAROLINA RAILROAD COMPANY MANAGEMENT TEAM




**Scott M. Saylor,** President
**Kat Christian,** Public Affairs Director
**Catherine Campbell,** Planning and Research Assistant

**Dan Halloran,** Vice President and Chief Financial Officer
**Nancy Pickett,** Office Manager
**Hilary Perez,** Archivist
**Glenn E. Hartsoe, P.E.,** Consulting Engineer
**Richard L. Wiley,** Senior Consultant—Economic Development

**Charles E. Burnell,** Vice President, Real Estate
**William C. Miller,** Property Manager
**Justin Madigan,** Assistant Corridor Manager and Information Technology
**John L. Spencer,** Real Estate Representative
**Cathy J. Deeley,** Real Estate Representative
**Kristian D. Forslin,** GIS Coordinator

# CONSOLIDATED FINANCIAL REPORT

## DECEMBER 31, 2009 AND 2008

CONTENTS

McGladrey & Pullen
Certified Public Accountants

**Independent Auditor's Report**

To the Stockholder and Board of Directors
North Carolina Railroad Company
Raleigh, North Carolina

We have audited the accompanying consolidated balance sheets of North Carolina Railroad Company and subsidiary (the "Company") as of December 31, 2009 and 2008, and the related consolidated statements of income, stockholder's equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of North Carolina Railroad Company and subsidiary as of December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

McGladrey & Pullen, LLP

Raleigh, North Carolina
April 30, 2010

**Consolidated Balance Sheets**
**December 31, 2009 and 2008**

| Assets | 2009 | 2008 |
|---|---|---|
| Current Assets | | |
| Cash and cash equivalents | $ 1,905,953 | $ 2,192,550 |
| Accounts receivable | 148,592 | 73,608 |
| Interest receivable | - | 321,307 |
| Prepaid expenses | 35,614 | 47,277 |
| **Total current assets** | 2,090,159 | 2,634,742 |
| | | |
| Property and Equipment | | |
| Roadway and land | 7,848,742 | 7,848,742 |
| Tracks, signals and bridges | 105,569,522 | 82,512,861 |
| Land | 4,608,830 | 4,604,513 |
| Buildings and improvements | 11,181,427 | 8,720,345 |
| Equipment and furniture | 1,114,780 | 1,093,141 |
| Construction in progress | 2,940,290 | 4,995,490 |
| | 133,263,591 | 109,775,092 |
| Less accumulated depreciation | 38,072,919 | 29,834,600 |
| **Property and equipment, net** | 95,190,672 | 79,940,492 |
| | | |
| Other Assets | | |
| Funded capital projects | 45,798,929 | 36,579,246 |
| Deposits | 16,725 | 18,725 |
| **Total other assets** | 45,815,654 | 36,597,971 |
| **Total assets** | $ 143,096,485 | $ 119,173,205 |

See Notes to Consolidated Financial Statements.

| Liabilities and Stockholder's Equity | 2009 | 2008 |
|---|---|---|
| Current Liabilities | | |
| Accounts payable and accrued expenses | $ 1,981,930 | $ 1,299,548 |
| **Total current liabilities** | 1,981,930 | 1,299,548 |
| Long-Term Liabilities | | |
| Security deposits | 22,532 | 84,955 |
| Deferred tax liability | 558,000 | 566,000 |
| | 580,532 | 650,955 |
| **Total liabilities** | 2,562,462 | 1,950,503 |
| Commitments (Notes 3 and 5) | | |
| Stockholder's Equity | | |
| Common stock, $.50 par value, 10,000,000 shares authorized; 317 shares issued and outstanding | 159 | 159 |
| Additional paid-in-capital | 186,306,184 | 167,303,013 |
| Accumulated deficit | (45,772,320) | (50,080,470) |
| **Total stockholder's equity** | 140,534,023 | 117,222,702 |
| **Total liabilities and stockholder's equity** | $ 143,096,485 | $ 119,173,205 |

**Consolidated Statements of Income**
**Years Ended December 31, 2009 and 2008**

| | 2009 | 2008 |
|---|---|---|
| Income: | | |
| Lease of roadway and land | $ 13,695,417 | $ 13,324,075 |
| Other lease income | 1,841,353 | 1,943,163 |
| Interest and dividend income | 782,625 | 1,068,348 |
| Other income | 48,449 | 236,268 |
| **Total income** | 16,367,844 | 16,571,854 |
| Expenses: | | |
| Wages and benefits | 1,255,060 | 1,211,025 |
| Professional fees | 341,508 | 595,406 |
| Contracted services | 391,954 | 124,100 |
| Reporting and public relations | 81,995 | 190,501 |
| Insurance | 143,652 | 195,555 |
| Franchise and property taxes | 551,561 | 205,577 |
| Depreciation | 8,238,320 | 8,080,839 |
| Repairs and maintenance | 293,621 | 276,994 |
| Engineering, surveying and mapping | 68,174 | 547,253 |
| General and administrative | 633,302 | 524,788 |
| **Total expenses** | 11,999,147 | 11,952,038 |
| **Income before income taxes** | 4,368,697 | 4,619,816 |
| Income tax expense | 60,547 | 51,956 |
| **Net income** | $ 4,308,150 | $ 4,567,860 |

See Notes to Consolidated Financial Statements.

**Consolidated Statements of Stockholder's Equity**
**Years Ended December 31, 2009 and 2008**

| | Common Stock | Additional Paid-in Capital | Accumulated Deficit | Stockholder's Equity |
|---|---|---|---|---|
| Balance, December 31, 2007 | $ 159 | $ 167,303,013 | $ (54,648,330) | $ 112,654,842 |
| Net income | - | - | 4,567,860 | 4,567,860 |
| Balance, December 31, 2008 | 159 | 167,303,013 | (50,080,470) | 117,222,702 |
| Capital contribution related to capital improvements projects | - | **19,003,171** | - | **19,003,171** |
| Net income | - | - | **4,308,150** | **4,308,150** |
| Balance, December 31, 2009 | **$ 159** | **$ 186,306,184** | **$ (45,772,320)** | **$ 140,534,023** |

**Consolidated Statements of Cash Flows**
**Years Ended December 31, 2009 and 2008**

| | 2009 | 2008 |
|---|---|---|
| Cash Flows From Operating Activities | | |
| Net income | $ 4,308,150 | $ 4,567,860 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 8,238,320 | 8,080,839 |
| Deferred income tax provision | (8,000) | (8,000) |
| Changes in assets and liabilities: | | |
| (Increase) decrease in: | | |
| Accounts receivable | (74,964) | (17,260) |
| Interest receivable | 321,307 | (83,533) |
| Prepaid expenses | 11,663 | 34,881 |
| Deposits | 2,000 | 33,000 |
| Increase (decrease) in: | | |
| Accounts payable and accrued expenses | (123,159) | (511,120) |
| Security deposits | (62,423) | 17,024 |
| **Net cash provided by operating activities** | 12,612,874 | 12,113,691 |
| Cash Flows From Investing Activities | | |
| Purchases of property and equipment | (3,679,788) | (4,353,289) |
| Funded capital projects, net | (9,219,683) | (7,817,233) |
| **Net cash used by investing activities** | (12,899,471) | (12,170,522) |
| **Net decrease in cash and cash equivalents** | (286,597) | (56,831) |
| Cash and cash equivalents: | | |
| Beginning | 2,192,550 | 2,249,381 |
| Ending | $ 1,905,953 | $ 2,192,550 |

**Consolidated Statements of Cash Flows** (continued)
**Years Ended December 31, 2009 and 2008**

| | 2009 | 2008 |
|---|---|---|
| Supplemental Disclosures of Cash Flow Information | | |
| Cash paid during the period for income taxes | $ 62,453 | $ 56,070 |
| Supplemental Schedule of Noncash Investing and Financing Activities | | |
| Additions to property and equipment paid by the North Carolina Department of Transportation | $ 19,003,171 | $ - |
| Construction costs included in accounts payable and accrued expenses | $ 805,541 | $ 849,583 |

See Notes to Consolidated Financial Statements.

## Notes to Consolidated Financial Statements

### Note 1. Nature of Business and Significant Accounting Policies

Nature of business: The North Carolina Railroad Company and subsidiary, a North Carolina company, (collectively referred to as the "Company"), owns approximately 317 miles of continuous railroad line extending from Charlotte, North Carolina to Morehead City, North Carolina. The Company's railroad facilities are operated by Norfolk Southern Railway Company ("NSR"). Pursuant to a Merger Agreement dated January 16, 1998, the Company merged with the Beaufort & Morehead Railroad Company ("B&M"), a company wholly owned by the State of North Carolina. The merger was effective April 1, 1998. Upon consummation of the merger, the State of North Carolina became sole owner of all of the common stock of the Company.

NC Railroad, Inc., ("NCRI") a wholly owned subsidiary of the North Carolina Railroad Company ("NCRR"), was formed on December 15, 2006. The subsidiary, NCRI, conducts certain taxable activities, such as leasing of commercial real estate, while NCRR conducts all tax exempt activities, such as leasing of railroad facilities and corridor management.

A summary of the Company's significant accounting policies follows:

Basis of presentation: The accompanying consolidated financial statements include the accounts of NCRR and its wholly owned subsidiary, NCRI. All intercompany transactions and balances have been eliminated in consolidation.

Use of estimates: In preparing its consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the balance sheet date and the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates.

Cash and cash equivalents: At times the Company places cash and cash equivalents with financial institutions in amounts that may be in excess of FDIC insurance limits. Cash equivalents include certificates of deposit and money market funds with original maturities of three months or less. Cash and cash equivalents that are restricted or designated by the Board of Directors for capital projects are reflected as Funded Capital Projects in the accompanying consolidated balance sheets. See Note 3.

Accounts receivable: Management considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts has been provided. If amounts become uncollectible, they are charged to operations in the period in which that determination is made.

An account receivable is considered to be past due if any portion of the receivable balance is outstanding for more than 30 days.

Property and equipment: Property and equipment are stated at cost less accumulated depreciation. The Company computes depreciation principally using the straight-line method over the following estimated useful lives:

| | Year |
|---|---|
| Buildings and building improvements | 25 |
| Bridges | 25 |
| Land improvements | 10 |
| Track and signals | 10 |
| Equipment and furniture | 3 - 7 |

**Note 1. Nature of Organization and Significant Accounting Policies (Continued)**

Values of the properties in the roadway and land account approximate 1916 valuations by the Interstate Commerce Commission. These properties represent fully depreciated roadway or land. The Company assesses long-lived assets for impairment whenever events or changes indicate that the carrying amount of the assets may not be recovered based on estimated future undiscounted cash flows. In the event such cash flows are not expected to be sufficient to recover the carrying value of the assets, the useful lives of the assets are revised or the assets are written down to their estimate fair values.

Lease of roadway and land revenue recognition: Revenue received from property that is operated by NSR is reflected in the statements of income when earned in accordance with the Company's lease arrangements on the accrual method.

Other lease revenue recognition: The Company leases certain property that is not operated by NSR. Revenue is reflected in the statements of income when earned. The Company also collects license fee revenue which is recognized when earned.

Income taxes: Pursuant to Section 11146 of the Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005 (the "Act"), a substantial portion of the Company's income is exempt from federal and state income taxes. The activities that generate income which is not exempt from federal and state income taxes pursuant to the Act are conducted in North Carolina Railroad, Inc. ("NCRI"). NCRI is a taxable entity and the liability method is used in accounting for income taxes, and deferred income tax assets and liabilities are determined based on differences between the financial reporting and income tax basis of assets and liabilities.

As part of the process of preparing the consolidated financial statements, the Company is required to estimate income taxes in each of the jurisdictions in which it operates. This process involves estimating the actual current income tax liability together with assessing temporary differences resulting from differing treatment of items for income tax and accounting purposes. These differences result in deferred income tax assets and liabilities. The Company must then assess the likelihood that its deferred income tax assets will be recovered from future taxable income. To the extent that the Company believes that recovery is not more likely than not, it must establish a valuation allowance. Significant management judgment is required in determining the provision for income taxes, deferred income tax assets and liabilities and any valuation allowance recorded against net deferred income tax assets.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more likely than not recognition threshold are measured as the largest amount of tax benefit that is more than 50% likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. With few exceptions, the Company is no longer subject to income tax examinations by the U.S. federal, state, or local tax authorities for years before 2006.

**Note 1. Nature of Organization and Significant Accounting Policies (Continued)**

Fair value of financial instruments: The Company estimates that the fair value of all financial instruments approximates the carrying amounts, primarily because of the short term nature of these instruments.

Recent accounting pronouncements: In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162* ("SFAS 168") to indicate changes to the GAAP hierarchy. Following the issuance of SFAS 168, the FASB will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates, which will not be authoritative in their own right but will serve to update the Codification, provide background information about the guidance, and provide the bases for conclusions on the changes to the Codification. On the effective date of SFAS 168, the *FASB Accounting Standards Codification* will become the single source of authoritative U.S. accounting and reporting standards to be applied by nongovernmental entities, except for rules and interpretive releases of the SEC under authority of federal securities laws, which are sources of authoritative GAAP for SEC registrants. All other nongrandfathered, non-SEC accounting literature not included in the Codification would become nonauthoritative. SFAS 168 will be effective for financial statements issued for interim and annual periods ending after September 15, 2009.

In May 2009, the FASB issued ASC 855, *Subsequent Events* ("ASC 855"), (formerly referenced as SFAS No. 165, *Subsequent Events)*. ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. Specifically, ASC 855 provides clarity around the period after the balance sheet date during which management of a reporting entity should evaluate events and transactions that my occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize such events or transactions, and the disclosure that an entity should make about such events or transactions. ASC 855 is effective for interim and annual reporting periods ended after June 15, 2009 and is to be applied prospectively. The Company adopted the new pronouncement and made the necessary disclosures related to subsequent events.

In September 2006, the FASB issued guidance under FASB ASC 820, *Fair Value Measurements and Disclosures* ("ASC 820"), (formerly known as SFAS No. 157, *Fair Value Measurements*). ASC 820 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurement. ASC 820 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under ASC 820, fair value measurements are disclosed by level within that hierarchy. In February 2008, the FASB approved and deferred the effective date of ASC 820 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those years. The Company adopted the provisions for financial assets and financial liabilities in its 2008 financial statements and the provisions for nonfinancial assets and nonfinancial liabilities that are recognized on a nonrecurring basis in 2009 with no significant impact on its financial statements.

**Note 1. Nature of Organization and Significant Accounting Policies (Continued)**

In July 2006, the FASB issued guidance under ASC 740, *Income Taxes* ("ASC 740"), (formerly referenced as Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN No. 48)). ASC 740 clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes*. It also provides guidance on various other aspects of accounting for income taxes, including recognition and measurement of tax positions taken on tax returns, balance sheet classification, de-recognition of tax benefits, interest and penalties, disclosure and transition. The Company adopted the provisions of ASC 740 in 2009 with no significant impact on its consolidated financial statements.

In January 2010, the FASB issued Accounting Standards Update ("ASU") 2010-06, which amends the *Fair Value Measurements and Disclosures Topic* of the Accounting Standards Codification. ASU 2010-06 requires additional disclosure of activity within and transfers between the three levels of fair value measurements as codified in ASC 820 and additional disclosure about inputs and valuation techniques for fair value measurements using Level 2 or 3. The provisions of ASU 2010-06 are effective for fiscal years beginning after December 15, 2009, except for certain new disclosures related to Level 3 activity which will be effective for fiscal years beginning after December 15, 2010. The adoption of ASU 2010-06 is not expected to have a significant effect on the Company's financial position, results of operations or cash flows.

In August 2009, the FASB issued ASU 2009-05, which amends the *Fair Value Measurement and Disclosure Topic* of the Accounting Standards Codification. ASU 2009-05 provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value of such liability using one or more of the techniques described by the update. ASU 2009-05 is effective for the Company in 2010. The adoption of ASU 2009-05 is not expected to have a significant effect on the Company's financial position, results of operation or cash flows.

**Note 2. Trackage Rights Agreement and Leases on Roadway and Land**

Prior to 1999, substantially all of the Company's assets were leased to NSR or its predecessors, in two leases dating to 1895 and 1939. The terms of the leases did not require either the Company or Norfolk Southern to renew the leases.

On August 10, 1999, the Board of Directors of the Company approved a Trackage Rights Agreement ("TRA") with NSR terminating the leases. The TRA's term is 15 years with two 15-year renewal options by NSR (45 years) for a base rental of $11,000,000 (minimum) beginning January 1, 2000, with annual adjustments based upon an inflation index and a 4 1/2 percent annual cap (arbitration of cap if it exceeds an average of 4 1/2 percent over any 7-year period). The TRA provides for transition of management of certain non-rail properties to the Company, maintenance of the Company's rail property, inspections, records sharing, and audit. The TRA was approved by the Surface Transportation Board on September 1, 1999.

The TRA grants exclusive freight trackage rights to NSR to conduct all freight operations over the NCRR railroad line. Under federal law National Rail Passenger Corporation ("Amtrak") operates over NSR operated lines under agreements with NSR. NSR is obligated under the TRA to provide rail service to all industries on the NCRR line and to dispatch rail operations on the NCRR line. NSR is obligated to maintain the NCRR line and any improvements made to the line by NSR for freight operations. Under the TRA, NSR does not have financial responsibility for passenger improvements made by the Company, North Carolina Department of Transportation ("NCDOT"), Amtrak, or other parties.

## Note 2. Trackage Rights Agreement and Leases on Roadway and Land (Continued)

Approximately 38 parcels not used in railroad operations have been returned to the Company for separate (non-NSR) management. These noncorridor properties are managed by the Company after transition from NSR management. The TRA contains provisions for responsibility for environmental matters by NSR and the Company.

NSR is responsible for any taxes on its freight operations. A Policy Planning Committee comprised of NCRR and NSR representatives addresses all future planning issues, capital improvements, and any disputes that arise under the TRA. In the event of any disagreements, NCRR and NSR are subject to binding arbitration under the TRA.

A lease of certain properties in Charlotte, North Carolina to NSR (the 1968 Lease) expires on December 31, 2067, and provides for an annual rental of $81,319 through December 2018. The 1968 lease provides that beginning on January 1, 2019, the annual rental for the remaining term of the 1968 Lease is 6 percent of the appraised value of the property. Under the terms of the 1968 Lease, all taxes connected with the property, except income taxes, are paid by the lessee. The 1968 Lease was not affected by the TRA.

## Note 3. Capital Commitments

Capital improvement agreement: On March 20, 2002, the Company entered into a capital improvement agreement (the "Capital Agreement") with NSR in order to establish an understanding between the parties about desired capital improvements as well as a means to fund individual projects pursuant to the TRA. The Capital Agreement calls for certain identified capital improvements to be made to the Company's railroad line (the "Projects"). As of December 31, 2009, the Company's share of the Projects total approximately $57 million and are scheduled for completion between 2010 and 2012.

The Capital Agreement calls for the execution of individual project agreements as appropriate and contains certain provisions with regard to construction responsibilities and cost allocation. The Capital Agreement provides for the funding of a capital program escrow account with an initial deposit of $500,000 by the Company and additional deposits of obligated Company capital improvement funds held pursuant to N.C. General Statute 124-5.1 to fund capital improvements as recommended and approved by the Company's Board of Directors.

Capital Account Funds Agreement: On June 21, 2002, the Company and the NCDOT entered into a Capital Account Funds Agreement (the "CAFA") pursuant to N.C.G.S. 124-5.1 NCDOT has various capital improvement projects in progress under the CAFA as of December 31, 2009 and management expects to record a capital contribution and related asset as the improvements are completed in future periods.

The Company has designated the following amounts (all invested in cash or cash equivalents) to capital improvement projects:

| | 2009 | 2008 |
|---|---|---|
| Restricted under construction contracts | **$ 6,059,435** | $ 3,159,235 |
| Restricted under the CAFA | **4,596,388** | 11,161,738 |
| Restricted for other capital improvements | **240,469** | 258,273 |
| Board designated funds | **34,902,637** | 22,000,000 |
| **Funded capital projects** | **$ 45,798,929** | $ 36,579,246 |

Board Designated Funds: The Board of Directors passed a resolution to designate $12,500,000 and $11,500,000 of unrestricted cash for use on capital improvement projects during 2009 and 2008, respectively.

## Note 4. Fair Value Measurements

Effective January 1, 2009, the Company adopted new accounting guidance ASC 820 related to fair value measurements which provides a framework for measuring fair value under generally accepted accounting principles.

Under ASC 820, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values.

Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

- Level 1 Inputs – unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- Level 2 Inputs – inputs other than quoted prices in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, discount values, volatilities, prepayment speeds, credit risks, etc.), or inputs that are derived principally from or corroborated by market data correlation or other means.
- Level 3 Inputs – unobservable inputs for determining the fair values of assets or liabilities that would reflect an entity's own determination about the assumptions that market participants would use in pricing the assets or liabilities.

Fair value on a recurring basis: At December 31, 2008, the Company had certificates of deposit which are measured at fair value on a recurring basis; that is, the instruments are measured at fair value at each reporting period. The following table presents the Company's financial instruments carried on the balance sheet by level within the fair value hierarchy (as described above) as of December 31, 2008. The Company had no assets or liabilities carried at fair value on a recurring basis at December 31, 2009.

| | 2008 | | | |
|---|---|---|---|---|
| | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
| Certificates of deposit | $ - | $ 17,500,000 | $ - | $ 17,500,000 |

## Note 5. Employee Benefit Plan

The Company sponsors a SEP-IRA Plan covering substantially all employees. Employees who earn greater than $400 in wages during the year are eligible to receive the contribution. The employer contribution percentage is approved annually by the Board and contributions are made to employee accounts in January and July. Employer contributions for the years ended December 31, 2009 and 2008 were $132,728 and $128,104, respectively. The Company incurred no plan administrative expenses during 2009 or 2008.

## Note 6. Future Minimum Lease Revenue

The Company derives income from leased commercial space and other property. Of the noncancellable leases, one lease, described in Note 2, comprises 88 percent of the lease income. Rental income received from this lease for the years ended December 31, 2009 and 2008 was $13.7 million and $13.3 million, respectively. The remaining noncancellable leases are related to the rental of commercial space. The following is a schedule of the minimum future rental income, excluding renewal periods, on the noncancellable operating leases at December 31, 2009.

| Year Ending December 31, | Amount |
|---|---|
| 2010 | $ 14,298,314 |
| 2011 | 14,305,790 |
| 2012 | 14,233,509 |
| 2013 | 14,107,297 |
| 2014 | 13,911,151 |
| Thereafter | 4,309,926 |
| | $ 75,165,987 |

## Note 7. Income Taxes

The Company's income before income taxes for the years ended December 31, 2009 and 2008 is broken down as follows:

| | 2009 | 2008 |
|---|---|---|
| Income before income taxes: | | |
| Non-taxable entity | $ 4,192,947 | $ 4,463,967 |
| Taxable entity | 175,750 | 155,849 |
| Income before income taxes | $ 4,368,697 | $ 4,619,816 |

The difference between the federal income tax computed by the statutory federal income tax rate of 34% and NCRI's income tax expense as reflected in the consolidated financial statements is as follows:

| | 2009 | 2008 |
|---|---|---|
| Income tax at statutory federal income tax rates | $ 59,748 | $ 52,989 |
| Increase attributable to: | | |
| State income tax, net of federal income tax benefit | 8,003 | 7,097 |
| Impact of graduated tax rates | (7,204) | (8,130) |
| | $ 60,547 | $ 51,956 |

**Note 7. Income Taxes (Continued)**

The Company's taxable subsidiary, NC Railroad Inc. has a deferred income tax liability at December 31, 2009 and 2008 as follows:

| | 2009 | 2008 |
|---|---|---|
| Noncurrent deferred tax liability, property and equipment | $ 558,000 | $ 566,000 |

The Company's total tax expense for 2009 and 2008 can be summarized as follows:

| | 2009 | 2008 |
|---|---|---|
| Current income tax expense | $ 68,547 | $ 59,956 |
| Deferred income tax expense | (8,000) | (8,000) |
| **Total income tax expense** | $ 60,547 | $ 51,956 |

**BUILDING A BETTER RAILROAD**

NORTH CAROLINA RAILROAD COMPANY

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